

The Terrorism Risk Insurance Act of 2002: A Summary of Provisions

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After the September 11, 2001, terrorist attacks on the United States, many businesses were not able to purchase insurance for risk of property loss due to future terrorist attacks. Congress recognized the importance of terrorism risk insurance for the health of the U.S. economy, and enacted the Terrorism Risk Insurance Act of 2002 (TRIA, P.L. 107-297) to create a temporary program to share future insured terrorism losses with the property-casualty industry. TRIA requires insurers to offer terrorism insurance to their commercial policyholders, preserves state regulation of insurance, and directs the Secretary of the Treasury to administer the program of sharing losses. This report, originally authored by Carolyn Cobb, provides a summary of the legislation as enacted in 2002. This legislation was extended and revised in 2005 by P.L. 109-144. For current information, see CRS Report RS21979, *Terrorism Risk Insurance: An Overview*, by Baird Webel. This report will not be updated.

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Terrorism: A New Insurance Risk

The September 11, 2001, attacks on the United States had many economic repercussions. One was that insurers realized that they would have to begin charging for covering the risk of losses due to terrorism, which generally had been included in commercial insurance policies without charge.¹ Early estimates of insured losses from the attack ranged from \$30 billion to \$75 billion, with later estimates settling in the lower end of that range.²

Domestic and foreign reinsurers — the insurers of insurance companies — absorbed massive losses from the 9/11 attacks. They were also unable to price for future such risks, since they did not have historical data on similar attacks, and relevant models for such losses did not exist. Unable to underwrite such risks, they withdrew from the market.³ Once the reinsurers stopped offering coverage for terrorism risk, insurers withdrew or tried to withdraw from the market.⁴ Terrorism risk insurance was soon not available or extremely expensive, which hurt the real estate, transportation, construction, energy, and utilities sectors.⁵ There was concern that lack of available or affordable terrorism insurance could threaten the U.S. economy as a whole.⁶

Congressional Action

The 107th Congress passed the Terrorism Risk Insurance Act of 2002⁷ (TRIA) to address the threat to the U.S. economy posed by potential terrorism losses.⁸ TRIA's legislative history began as the House Committee on Financial Services held a hearing in September 2001,⁹ and its Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises held another in October 2001.¹⁰ Chairman Oxley introduced H.R. 3210 in November 2001, and the committee reports on the bill appeared later that month.¹¹ During the November 29, 2001 debate

¹ Terrorism risk insurance is often confused with war risk insurance, which is a different coverage. Risk of losses due to declared and undeclared war has historically been excluded from commercial and personal insurance. Since September 11, 2001, war risk is one exclusion, and terrorism risk is another.

² See "Terrorism Risk and Insurance," Insurance Information Institute website, available at <http://www.iii.org/media/hottopics/insurance/terrorism/>.

³ Dan Miller, Senior Economist, *Economic Perspectives on Terrorism Insurance*, study prepared for the Joint Economic Committee, 107th Congress, 2nd sess., May 23, 2002 (Washington: GPO, 2002), pp. 1-3.

⁴ California, Florida, Georgia, New York, and Texas refused to allow insurers to exclude terrorism risk. Prices in those states rose, and the level of coverage dropped. *Ibid.*, pp. 4-8.

⁵ *Ibid.*, p. 6.

⁶ *Ibid.*, pp. 8-15. See also U.S. Congress, Subcommittee on Oversight and Investigations, House Committee on Financial Services, hearing statement of Richard J. Hillman, Director, Financial Markets and Community Investment, GAO, *Terrorism Insurance: Rising Uninsured Exposure to Attacks Heightens Potential Economic Vulnerabilities*, GAO Testimony 02-742T (Washington: Feb. 27, 2002).

⁷ P.L. 107-297, 116 Stat. 2322 (eff. Nov. 26, 2002) (15 U.S.C. §6701 et seq.).

⁸ *Ibid.*, sec. 101(a), pp. 2322-2323.

⁹ U.S. Congress, House Committee on Financial Services, *America's Insurance Industry: Keeping the Promise*, hearing, 107th Congress, 1st sess., Sept. 26, 2001 (Washington: GPO, 2002).

¹⁰ U.S. Congress, Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, House Committee on Financial Services, *Protecting Policyholders from Terrorism: Private Sector Solutions*, 107th Congress, 1st sess., Oct. 24, 2001 (Washington: GPO, 2002).

¹¹ U.S. Congress, House Committee on Financial Services, *Terrorism Risk Protection Act*, report to accompany H.R. 3210, 107th Congress, 1st sess., H.Rept. 107-300, part 1 (Washington: GPO, 2001); U.S. Congress, House Committee on Ways and Means, *Terrorism Risk Protection Act*, report to accompany H.R. 3210, 107th Congress, 1st sess., H.Rept.

on the bill, the House accepted a substitute bill by a narrow vote. The H.R. 3210 that emerged from the House provided a temporary government loan to insurers in the event of an act of terrorism, and it contained some controversial provisions on litigation management, particularly limits on collateral source recoveries and attorneys' fees.

In the Senate, four bills were introduced in 2001, but no action was taken that year. Efforts in April 2002 to reach a unanimous consent agreement to bring H.R. 3210 to the floor and amend it by substituting compromise language by Senators Dodd, Gramm, and Sarbanes were unsuccessful. Instead, in June 2002, Senators Dodd, Reid, Sarbanes, and Schumer introduced a compromise proposal, S. 2600, which passed the Senate in July 2002.¹² It differed from H.R. 3210 in that it did not require insurers to repay all federal assistance nor contain the controversial liability reform provisions.¹³

Conferees were Senators Sarbanes, Dodd, Reid, and Schumer and Representatives Oxley, Baker, Ney, Kelly, Shays, Fossella, Ferguson, LaFalce, Kanjorski, Bentsen, Maloney, Hooley, and Conyers. Their November 2002 conference report designated the conference bill as H.R. 3210.¹⁴ The President signed it on November 26, 2002, and it became effective upon his signature as P.L. 107-297.

Congressional Goals and TRIA's Substance

Congress's stated goals in enacting TRIA were to (1) establish a temporary federal program of shared public and private compensation for insured losses to allow the private market to stabilize, (2) protect consumers by addressing market disruptions transparently and by ensuring the availability and affordability of property-casualty insurance for terrorism risks, and (3) preserve state regulation of insurance.¹⁵ The easiest way to understand TRIA is to examine how the act addresses each of these goals.

To allow time for the private market to stabilize, TRIA established a short-term program for the federal government to share insured commercial property-casualty losses with the private insurance market. The sharing extends from enactment through December 31, 2005.¹⁶ Insured losses would be shared in four ways. First, the federal government shares in any insurer's losses only if the aggregate insured losses from an act of terrorism exceed \$5 million.¹⁷ Second, each insurer is responsible for paying out a certain amount in claims — known as its deductible — before it can call upon federal assistance. Its deductible is directly proportionate to its size.¹⁸

107-300, part 2 (Washington: GPO, 2001).

¹² Sen. Daschle and the Presiding Officer, remarks in the Senate, *Congressional Record*, daily edition, vol. 148, July 25, 2002, p. S7332.

¹³ S. 2600, sec. 4(e), sec. 10.

¹⁴ U.S. Congress, conference report to accompany H.R. 3210, H.Rept. 107-779, 107th Cong., 2nd sess. (Washington: GPO, 2002)(hereinafter referred to as Conference Report). See also CRS Report RS21211, *Terrorism Insurance — Comparison of H.R. 3210, S. 2600, and Conference Report*, by S. Roy Woodall, Jr.

¹⁵ P.L. 107-297, 116 Stat. 2322, sec. 101(b), p. 2323. The act covers only U.S. commercial property-casualty insured losses due to acts of terrorism certified by the Secretary of the Treasury. It does not cover losses due to acts of war declared by Congress, except for workers compensation losses. *Ibid.*, sec. 102(1), pp. 2323-2324.

¹⁶ *Ibid.*, sec. 103(c)(2), p. 2328.

¹⁷ *Ibid.*, sec. 102(1), pp. 2323-2324.

¹⁸ In 2003, the deductible is 7% of each insurer's direct earned premium. In 2004, it is 10% of each insurer's direct earned premium, and in 2005, 15%. *Ibid.*, sec. 102(7), p. 2325.

Third, the federal government will pay 90% of each insurer's losses above its deductible.¹⁹ Fourth, for any year in which terrorism causes aggregate insured losses greater than \$10 billion to \$15 billion, insurers must impose a limited surcharge on policyholders to reimburse the federal government.²⁰ Congress charged the Secretary of the Treasury with certifying an act of terrorism²¹ and with administering the program.²²

Congress protected consumers by nullifying all commercial terrorism exclusions in force on the date of TRIA's enactment.²³ TRIA also requires all property-casualty insurers, as a condition of receiving federal assistance for terrorism losses, to make terrorism insurance available prospectively to their commercial policyholders in a disclosure required to be made by February 24, 2003.²⁴ This "make available" requirement is to be in effect until the end of 2004, with the Secretary of the Treasury having the authority to extend it until the end of 2005. The proffered coverage may not differ materially from the terms, amounts, and other coverage limitations applicable to coverage for other types of losses.²⁵ The disclosure must be clear and conspicuous, and it must reveal both the premium charged for terrorism insurance and the federal share of compensation.²⁶ TRIA in effect gave policyholders coverage for terrorism risk immediately, without charge, for the period until the policyholder accepted or declined the coverage TRIA required insurers to offer.²⁷ The policyholder is not, however, required to purchase the coverage. If the policyholder declines the insurance, its insurer may reinstate an exclusion for terrorism losses.²⁸ TRIA did not limit what insurers could charge for terrorism risk insurance, though it did give state regulators the authority to curtail excessive, inadequate, or unfairly discriminatory rates.²⁹

Congress's third goal was to preserve state regulation of insurance.³⁰ Section 106 of the act does so expressly, with some exceptions. One exception is the definition of an "act of terrorism;" TRIA's definition applies notwithstanding any definition in state law.³¹ A second exception is

¹⁹ Ibid., sec. 103(e)(1), p. 2328.

²⁰ The threshold is \$10 billion in 2003, \$12.5 billion in 2004, and \$15 billion in 2005. Ibid., sec. 103(e)(6), p. 2329. The surcharge is limited to 3% of each policyholder's premium and is imposed only beneath the annual threshold. Ibid., sec. 103(e)(8), p. 2330. The program has an annual cap of \$100 billion. Ibid., sec. 103(e)(2), p. 2328. This lets the private market fund smaller losses and tap federal funding for larger events. See the Tillinghast-Towers Perrin Update (Dec. 2002), Figure 3, p. 7, available at

http://www.towersperrin.com/tillinghast/publications/publications/till_update_us/Terrorism_risk_ins_act/Update2_12_02.pdf, for a diagram on how any 2003 losses would be shared.

²¹ Ibid., sec. 102(1), p. 2323.

²² Ibid., sec. 103(a)(2), p. 2327.

²³ Conference Report, p. 26. P.L. 107-297, 116 Stat. 2322, sec. 105(a), p. 2334.

²⁴ P.L. 107-279, 116 Stat. 2322, sec. 103(b), p. 2327(not later than 90 days after enactment).

²⁵ Ibid., sec. 103(c)(1), p. 2328.

²⁶ Ibid., sec. 103(b), p. 2327. Congress intended this disclosure to enhance competition by enabling consumers to comparison shop. Conference Report, p. 24.

²⁷ Conference Report, p. 26.

²⁸ P.L. 107-279, 116 Stat. 2322, sec. 105(c), p. 2334.

²⁹ Ibid., sec. 106(a)(1)(B), p. 2334.

³⁰ Conference Report, p. 26; P.L. 107-297, 116 Stat. 2322, sec. 101(b)(2), p. 2323 ("preserving State regulation of insurance and consumer protections.").

³¹ Ibid., sec. 106(a)(2)(A), p. 2334. Other definitions in the act also preempt state statutory definitions. Ibid., sec. 106(a)(1), p. 2334. These would include, for example, definitions of the terms "affiliate" and "control." Ibid., sec. 102(2)-(3), p. 2324.

TRIA's limited preemption of state rate and form filing requirements.³² TRIA preempts all prior approvals through December 31, 2003, though it does allow any state to invalidate an excessive or discriminatory rate³³ and any state with prior approval authority to review policy forms after their use.³⁴ This means that states retain considerable authority over rates and terms for terrorism coverage. A third exception to state regulation of insurance is TRIA's requirement that all workers compensation coverage include not only coverage for terrorism risk but also for war risk.³⁵ Finally, TRIA also accomplishes this third goal — of preserving state regulation of insurance — by directing the Treasury Secretary to consult with the National Association of Insurance Commissioners (NAIC)³⁶ on several implementation issues. These include treatment of captive insurers,³⁷ studies required by the act,³⁸ and access to information about rates.³⁹

Other Important TRIA Provisions

As enacted, H.R. 3210 followed the Senate provisions on liability reform. Section 107 of TRIA requires any legal action for property damage, personal injury, and death resulting from any certified act of terrorism to go to federal court. The only actions that may be brought in state court are those in which the defendant in the case has knowingly committed or conspired to commit an act of terrorism.⁴⁰ These reforms apply only during the effective period of the program.⁴¹ Finally, Section 107 confers a right of subrogation⁴² on the United States and expressly saves contractual rights to arbitration.⁴³

Title II of the act allows satisfaction of judgments from blocked assets of terrorists, terrorist organizations, and state sponsors of terrorism. For purposes of this Title, the definition of an act of terrorism is broader than discussed above.⁴⁴

Title III of the act expands the authority of the Federal Reserve Board to act in certain circumstances. It would allow at least two members of the Board to act in “unusual and exigent

³² In most states, property-casualty insurers must apply for each state insurance regulator's prior approval of the rates it plans to charge commercial policyholders and of the terms and conditions of the policies it intends to offer them. In those states, insurers may not use those rates or forms unless and until the regulator expressly approves them. Some states do not require commercial insurers to obtain prior approval but instead require insurers to give the insurance regulator that information contemporaneously with its use.

³³ *Ibid.*, sec. 106(a)(2)(B), p. 2334.

³⁴ *Ibid.*

³⁵ *Ibid.*, sec. 102(1)(B)(i), p. 2324.

³⁶ The NAIC is the voluntary association of insurance regulators from the 50 states, the District of Columbia, Puerto Rico, and the three U.S. territories. It has its main office in Kansas City, additional offices in New York City and the District of Columbia, 422 authorized staff positions, and a budget of \$54.4 million.

³⁷ *Ibid.*, sec. 103(f), p. 2331.

³⁸ *Ibid.*, sec. 103(h)-(i), p. 2332, and sec. 108(d)(1), p. 2336.

³⁹ *Ibid.*, sec. 104(f), p. 2333.

⁴⁰ *Ibid.*, sec. 107(a)-(b), p. 2335.

⁴¹ *Ibid.*, sec. 107(e), p. 2336.

⁴² This means that the United States may bring a legal action to recover monies it has paid out under the act, so, for example, it could recover from terrorists' assets pursuant to Title II of the act or recover payments made to insurers.

⁴³ *Ibid.*, sec. 107(c)-(d), p. 2336.

⁴⁴ *Ibid.*, sec. 201(d), p. 2339.

circumstances” when “action is necessary to prevent, correct, or mitigate serious harm to the economy or the stability of the financial system of the United States”⁴⁵

Congress directed the Secretary of the Treasury to conduct an expedited study of whether the program should be extended to providers of group life insurance and, depending on the results of the study, to apply the program appropriately.⁴⁶ It also directed the Secretary to “study the potential effects of acts of terrorism on the availability of life insurance and other lines of insurance coverage, including personal lines.”⁴⁷ Congress directed the Secretary to report the results of the latter study by late August 2003.⁴⁸ A final study is due from the Secretary to Congress by June 30, 2005, on the effectiveness of the program, the ability of the property-casualty industry to offer terrorism insurance after the program ends, and on the “availability and affordability of such insurance for various policyholders, including railroads, trucking, and public transit.”⁴⁹

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⁴⁵ Ibid., sec. 301, pp. 2340-2341.

⁴⁶ Ibid., sec. 103(h), p. 2332.

⁴⁷ Ibid., sec. 103(i)(1), p. 2332.

⁴⁸ Ibid., sec. 103(i)(2), p. 2332 (requiring a report within nine months of enactment).

⁴⁹ Ibid., sec. 108(d), p. 236.